VZCZCXRO2258
RR RUEHCN RUEHGH
DE RUEHBJ #8879/01 1320630
ZNR UUUUU ZZH
R 120630Z MAY 06
FM AMEMBASSY BEIJING
TO RUEHC/SECSTATE WASHDC 5101
INFO RUEHCN/AMCONSUL CHENGDU 6228
RUEHGZ/AMCONSUL GUANGZHOU 0462
RUEHGH/AMCONSUL SHANGHAI 4506
RUEHSH/AMCONSUL SHENYANG 6029
RUEHHK/AMCONSUL HONG KONG 7357
RUEHIN/AIT TAIPEI 5528
RHEHNSC/NSC WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUEHGV/USMISSION GENEVA 1045
RUCPDOC/USDOC WASHDC

UNCLAS SECTION 01 OF 03 BEIJING 008879

SIPDIS

SENSITIVE
SIPDIS

STATE FOR EAP/CM, EB/TPP/BTA, AND EB/IFD/OIA
STATE PASS USTR FOR STRATFORD/MCCARTIN/KEMP
TREASURY FOR OASIA/ISA
USDOC FOR 5101/ITA/IA
USDOC FOR 4220/ITA/MAC
USDOC FOR 1003/ITA/OUS
USDOC FOR 6310/ITA/TD/OIEM

E.O. 12958: N/A
TAGS: ECON EIND ENRG ELAB SENV WTRO CH
SUBJECT: STEEL CHINESE GOVERNMENT RESEARCHERS, STATE-OWNED ENTERPRISE EXECUTIVE DISCUSS STEEL POLICY ISSUES

REF: (A) 05 BEIJING 18221

(B) BEIJING 08615

¶1. (SBU) Summary: Chinese steel industry analysts and insiders consistently point to China's private steel mills as the target of the Central Government's call for reductions in domestic steel production capacity. Beijing will use environmental protection and energy conservation laws and regulations as its primary tools in this effort. At the same time, Beijing is promoting the consolidation and technological advancement of its larger state-owned steel mills in a bid to create internationally competitive steel mills. The most
significant roadblock to the reduction in capacity will be Beijing's need to coordinate its actions with local governments bent on preserving local tax revenue and jobs, according to local steel experts. China's continued growth in demand for steel also will complicate efforts to eliminate low-quality production. Beijing's mounting concern about broader industrial overcapacity ensures that the steel policy and issues relating to it will not fade
away anytime soon. End Summary.

Sinosteel Executive Comments On Steel Industry History, Steel Policy
---

¶2. (SBU) Vice President of Sinosteel Corporation, Dong Zhixiong, commenting on the National Development and Reform Commission's (NDRC) 2005 Steel Policy, said that the national policy is centered around a philosophy of transitioning China from being a large steel making country to that of a strong steel making one. China must contain the growth of its steel industry if it is to accomplish this goal. Dong said that between 2000-2005 China invested some USD 85 billion in its steel sector. China in 1996 exceeded 100 million metric tons of annual production for the first time in its history. It took China another seven years to add an additional 100 million metric tons of annual production, but by the end 2004, China already had added yet another 100

million metric tons of
production. China produced some 340 million metric tons of steel in 2005, accounting for around 30 percent of the world's total steel production, and in 2006 will add still another 40 million metric tons of production capacity. Vice President Dong said that the most serious difficulty in implementing the steel policy will be the lack of coordination between Beijing and local level governments. The NDRC is preparing a list of outdated steel producers that will be targeted for elimination, but coordination and cooperation with local authorities will be necessary to achieve the closures. (Note: For previous Post reporting on China's steel policy, please see Ref (A). End Note.)

¶3. (SBU) Vice President Dong said China must contain the rapid growth in the steel industry if it is to achieve the desired reform advocated in the steel policy. China has some 100 million metric tons of outdated and inefficient steel production that must be eliminated. Dong said that there are three primary elements to the steel policy. First, China needs to change its steel output to focus on value-added products rather than on gross production. Second, China must consolidate its steel sector through a strengthening of the integration of its steel mills. The country currently has more than 800 steel mills, with the 15 largest mills only accounting for around 45 percent of China's total steel production. China's goal is for its top ten largest mills to account for some 50 percent of total production by 2010, and by 2020, aspires to have its top ten steel mills accounting for some 70 percent of total production. Third and finally, China wants to reduce the industry's annual energy consumption and environmental degradation resulting from steel production.

Development Research Center Official Weighs In On Steel Policy Issues

---

¶4. (SBU) Yang Jianlong, Senior Research Associate at the Industrial Economics Research Department of the State Council's Development Research Center, said the Central Government enacted the steel policy to remedy the trend of local and provincial governments promoting small-scale steel mill projects, including those involving private investment, without adhering to Central Government standards. Yang acknowledged that during 2003 and 2004 these types of small-to-medium sized steel enterprises helped China to meet its high construction sector-led demand for iron and steel. The enterprises, however, concomitantly caused problems, most notably environmental damage, disproportionately high energy usage, and production of only one type of steel product. The Central Government wants to discourage the further establishment of these types of
enterprises and to discourage enterprises lacking steel-making experience from entering the market.

¶5. (SBU) Yang said the steel policy is intended to promote industry consolidation, along with the growth of the higher technical standards and production skills necessary to compete with major international steel industries. Rather than simply shutting down enterprises, Beijing and local governments will look to market competition and relevant laws and regulations to foster the needed consolidation of the industry. The Central Government, for its part, will aid consolidation through the setting of higher environmental and technological standards for new and existing steel enterprises. These
standards will be reflected in the Natural Resources Savings Law that is currently being drafted and through amendments in the Environmental Protection Law. Yang suggested that the environmental law amendments in particular would require many small steel enterprises to quickly invest in expensive environmental technology to the point that many would be forced to withdraw from the market.

CASS Researcher Notes Private Mills The Overcapacity Problem

¶6. (SBU) Dr. Lu Tie, Professor, Institute of Industrial Economics at the Chinese
Academy of Social Sciences (CASS), said that China as of April 2006 has some 470 million metric tons of steel production capacity. China must still import some high-end steel products, despite this production capacity. Dr. Lu stated that this is clear evidence that the Chinese Government must simultaneously take steps to eliminate backward steel production and raise the technical standards of the remaining steel enterprises. The Central Government must carefully consider local political concerns, particularly the loss of tax revenue and jobs in the local economy, while undertaking this reform.

¶7. (SBU) Dr. Lu stated that entry-level steel production technology during the past ten years hs progressed rapidly, facilitating the start up of many private steel enterprises in China. These recent entrants into the Chinese steel market are largely making low-end products, primarily for the construction sector. Dr. Lu noted that private steel enterprises currently account for around 100 million metric tons of steel production in China. These enterprises have a cost advantage over SOE's because they employ low-wage migrant workers to whom they do not provide social services such as health insurance. The private steel enterprises have also largely avoided investing in costly environmental
protection technology and equipment. Dr. Lu stated that conversely, SOE steel mills are attempting to retool their production processes to produce increasingly complicated steel products and to respond to Central Government calls for increased investment in environmental protection and energy conservation technologies.

CISA Backs CASS Assessment Of Overcapacity

¶8. (SBU) Yang Zunqing, Deputy Secretary-General of the China Iron and Steel
Association (CISA), stated that the Chinese steel industry is currently in a situation where it has too little high-value production capacity while carrying overcapacity in low-value production capacity. CISA's position is that the Chinese steel industry must do a much better job of coordinating and organizing its product pattern to alleviate this problem. Yang noted that some 700 private or partially stated-owned steel mills are members of CISA compared to only around 100 wholly-owned SOEs. Despite representing only about 12 percent of CISA's rolls, the SOE's account for almost 60 percent of China's steel making capacity. Yang went on to note that based upon a metric of production quality, environmental protection efforts, and energy consumption, a high percentage of China's backward steel production capacity is in its private steel mills.
Some sixty percent of China's steel production capacity is located in northeast China, according to Yang. A large percentage of these mills are situated in or near large cities, and many are in areas where there are water shortages. Yang stated that the policy-mandated reorganization of the Chinese steel industry must also lead to a rectification of this geographical problem as well.

Comment: Small, Private Steel Mills Beware, Many Want To Shut You Down
---

¶9. (SBU) The Chinese Government is very concerned about industrial overcapacity as evidenced by recent articles relating to this problem in the local and English language press. Environmental protection and energy conservation measures appear to the most robust tools available to Beijing at present to address this problem. Steps such as charging varying electricity rates to enterprises in energy-intensive industries, including the steel sector, based upon a NDRC determination whether a particular enterprise is classified as encouraged, permitted, restricted, or eliminated, are currently underway.

The NDRC, in its November 2005 circular implementing this practice, stated that it is a macro-economic control combining price and industrial policy that has already been proven to restrict excess development of energy-intensive industries.

¶10. (SBU) CISA, CASS, and other local observers consistently imply that the 100 million metric tons of excess capacity identified in the steel policy resides in small, private mills, and these enterprises should bear the brunt of the NDRC's macro-economic control measures. It is unclear whether the Central Government's policies will actually remove this production capacity in the face of forecasts that China's steel demand will continue to grow'CISA estimates by 10-13 percent in 2006'in the foreseeable future. It is increasingly apparent based upon local and English language press reports, along with recent Econoff visits to steel enterprises in Hebei Province (Reftel B), that the mandated consolidation of SOE steel enterprises is underway, and that Beijing intends for these new conglomerates to compete internationally both in terms of gross output and in the technology employed to produce their products. China's considerable challenge moving forward in implementing its steel policy will be to balance this consolidation and technological upgrade of its state-owned steel enterprises, while simultaneously meeting double-digit increases in steel demand and fulfilling its stated intent to remove excess steel production capacity.

RANDT